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Broker pays manager for buy, sell privilege

By Michael Clowes

BOSTON—In what may be a first in the investment world, a brokerage house has paid a commission to pension funds, through an investment manager, for the privilege of executing an order.

Dean LeBaron, president of Batterymarch Financial Management Inc., confirmed that a brokerage firm, which he declined to identify, in effect paid Batterymarch's clients a commission to execute buy and sell orders for the funds.

Though Mr. LeBaron declined to confirm the amount of the commission, according to reports on Wall Street the clients, through Batterymarch, received one cent per share for the transactions.

Normally buyers and sellers of stocks pay brokers a commission which is negotiated according to the size of the transactions.

Commissions on large blocks range from five to 10 cents per share, although Batterymarch generally pays only three cents a share for its transactions, according to Mr. LeBaron.

While news that a broker was paying a commission for executing an order caused a stir at a Securities Industries Assn. (SIA) seminar in New York last month, other observers saw it as no threat to the industry and suggested that what the broker paid to Batterymarch in commissions it more than recovered from the clients in other ways.

According to Mr. LeBaron, the negative commission came about when Batterymarch had taken on five new clients and was clearing out the portfolios of stocks that Batterymarch did not like and replacing them with stocks it favored.

Batterymarch combined the transactions for all the accounts into one package and asked some of the largest brokers it normally deals with for bids.

"The total package was about $400 million, $200 million on each side," Mr. LeBaron said. "We thought that at that high volume we ought to get a better deal for each client by combining the power of all of them."

The brokers asked for bids were not told the names of the issues Batterymarch wanted to sell, or what it wanted to buy. But, they were told the approximate dollar value of the package, the number of different issues involved, the characteristics of the issues—how many were institutional names and average trading volume and any peculiar delivery characteristics involved.

"The broker with the lowest bid won," Mr. LeBaron said.

"Then we told him what we wanted to buy and what we wanted to sell.

"We gave him the list of sells and told him to sell them when they moved up 2% or more over a neutral strike price set based on the previous day's closing price."

Similarly, the broker was given a list of the stocks Batterymarch wanted to buy and a neutral strike price and told buy the stocks when the price declined by 2% or more from the strike prices.

The strike prices are changed each day in accordance with the movements of the market, Mr. LeBaron noted.

"There is a name for the process," he said. "It's called a Markov Chain with absorbing barrier."

If a stock on the sell list underperforms the market for six or eight weeks so that the broker cannot sell it according to the 2% advance criterion, then Batterymarch sells it

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New enchantment with equities

NEW YORK—The year 1980 and the January just passed in particular may be a watershed for the stock market.

The evidence suggests that the largest of the nation's stock market investors—institutions and pension funds—may once again be getting enchanted with the equity markets.

For this first time since the 1973-74 bear market, when many investors dramatically shifted asset allocations from stocks into bonds, there appears to be an equally dramatic shift back into the stock market, as evidenced by record-breaking stock market trading volume during January.

An informal survey of more than 30 money managers and pension fund sponsors by this newspaper last week indicates that the major reason for the recent institutional endorsement of stocks may not be so much because a major market advance is perceived ahead as because there is a general disillusionment with returns in recent years from fixed-income investments.

Indeed, *Pensions & Investments'* Performance Evaluation Report (P.I.P.E.R.) for the period ending Dec. 31, 1979, shows that the median returns for equity commingled bank and insurance funds outpaced the median fixed-income five years in a row.

And those are merely "average" numbers. Many fund sponsors can be heard boasting about returns of 30%, 40% and even 50% having been turned in by their investment managers for 1979.

Further, not only did most money managers outpace the Consumer Price Index bogey (up 13.3% for 1979), they also whipped the S&P 500 (up 18.6%) by substantial margins.

Commenting on the possible broad shift to equities, a Pennsylvania pension fund sponsor noted simply that fixed-income results have been "terrible." He added, in October 1979, when both the stock and the bond markets retreated sharply, the bond market did much worse than the stock market. In addition, not only did the bond market fail to recoup its losses, it has since tumbled to new lows with venerable telephone long bonds yielding more than 12%.

At the same time, the stock market indices, notably the New York Stock Exchange composite index has climbed to record highs. The index closed 1979 at 61.95 and has since (as of January 28) reached a new high of 65.96 surpassing the old record set in 1973.

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The reporting for this story was by Charles Epstein, Steve Hemmerick, Clare Minick, Maria Crawford Scott, Linda Sojacy and Les Stern. It was written by senior editor Minick.

DOL regulation raises ire

Venture capitalists fuming

By Les Stern

WASHINGTON—A top-level memo from the White House to the Labor Department expresses administration concern—if not consternation—over the agency's proposed definition of plan assets (*Pensions & Investments*, January 21).

The memo—sent from President Carter's chief domestic adviser, Stuart Eizenstat, with the approval of the President to Labor Secretary Ray Marshall—expresses fears that the proposed regulation would dry up sources of venture capital.

The venture capitalists have been fuming that the proposal would make it almost impossible for pension funds to invest in venture capital, and those screams have reached a White House extremely sensitive to small business in this election year.

The memo expresses concern that the regulation "may have a chilling effect on investments in venture capital." It noted that while the President is aware of the need to protect plan assets and is "appreciative" of the prudent man rule, under the circumstances it would be "desirable to schedule a public hearing."

The memo also suggested until a final rule is published, existing interpretations should apply and that the final rule not be retroactive.

While an administration source denied that the memo indicated "White House pressure" on the Labor Department, he interpreted the message as suggesting that "Labor has to take a fresh new look at the plan assets rule."

He added that while protection of plan assets is in the department's mandate, so is support of venture capital.

The White House isn't the only part of the administration concerned with the proposal. The Small Business Administration (SBA), obviously, is upset.

"I don't like the proposal," SBA director Vernon Weaver said during a breakfast meeting with the press recently.

Milton Stewart, chief counsel for advocacy at the SBA, who has a venture capital background, said the regulation would have "a devestating effect" on venture capital.

Meanwhile at the DOL, pension administrator Ian Lanoff said he is not ready to acquiesce to the lobbying effort of the venture capitalists. But, there will be a hearing, probably late this month.

"We are going to ask (venture capitalists)

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Inside

Here's a $7 million fund that has moxie

2 "The riskiest investment we have is equities," said a financial officer for Echlin Manufacturing Co.'s pension fund ($7 million in assets). Some surer things for this aggressively managed fund: oil and gas partnerships, an arbitrage account and convertible bonds.

Pulse of top investors beats regular

3 The nation's largest investment managers and the very largest investors—pension funds—are in remarkably close agreement about recession, inflation and the state of the stock market this year, according to a survey of the top 100 fund sponsors and top 100 money managers. If the rules of the game don't change it might not be a bad year after all.

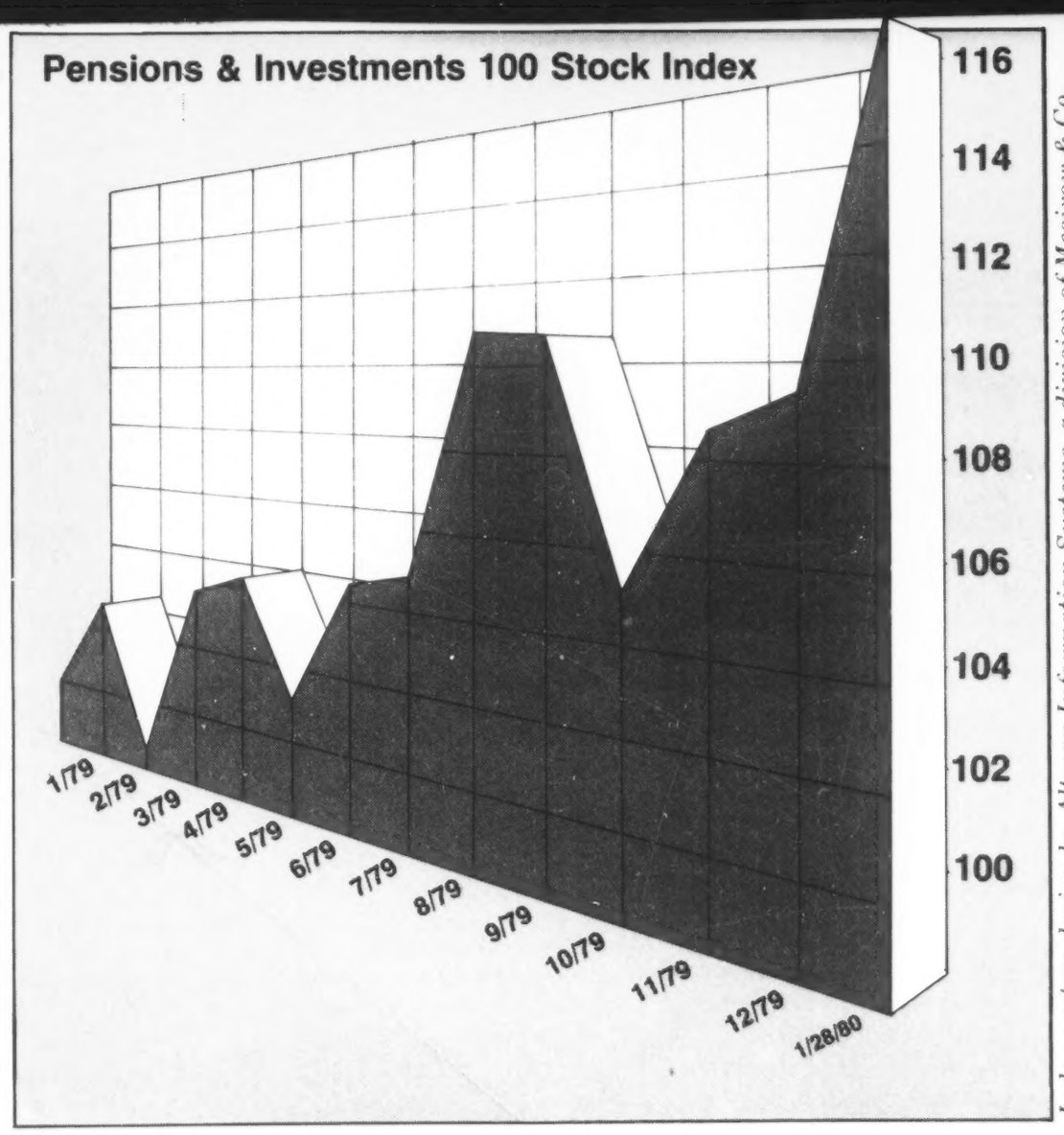
Options earn L.A. fund $3 million

3 The best spokesman for an investment concept is still experience. If you buy that, and the experience of a public fund in Los Angeles, all the talk about options writing as an investment strategy for pension funds may have been more than just talk. The city employes fund in Los Angeles, for example, has earned $3 million writing options against equity holdings over the past 30 years. The fund plans to look at futures next, according to fund officials.

All that glitters here is hindsight

8 The wild gyrations of the gold market have had little impact for pension investors, who have generally shunned the metal as an investment. But then there's the story of one Chicago fund that wanted to buy at $300 an ounce, but was talked out of the idea by its financial adviser.

Steelworkers seek increases—page 3



Index system design by Altman Information Systems, a division of Mesirow & Co.

Oils prime P&I Index gain

NEW YORK—The *Pensions & Investments* index, which tracks the 100 largest holdings of pension funds and other institutions, outperformed the other major stock indices in the two weeks ended January 18.

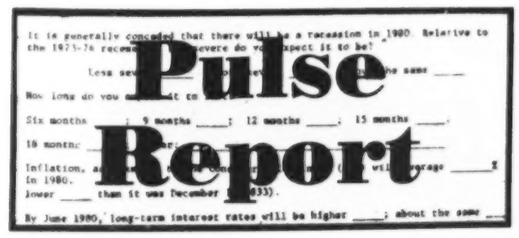
During that period the *P&I* index gained 5% to 116.324 while the Standard & Poor's 500 index gained 4.47%, the Dow Jones Industrial Average gained 1.73%, and the New York Stock Exchange Composite gained 3.74%.

The strong gain in the index for the two weeks apparently reflects the heavy weighting of major oil company stocks in the index as four of the five largest gains within the index were by oil company stocks.

The largest gain was 31.3% by Marathon Oil, followed by Getty Oil, 22.6%, Schering Plough, 21.3%, Shell Oil, 20.6%, and Texaco Inc. 20.5%.

The index, which was set at 100 at the start of 1979, is based on the 100 largest institutional holdings as reported to the Securities & Exchange Commission on form 13f and published by Computer Directions Advisers Inc., Silver Spring, Md. It was developed for *P&I* by Altman Information Systems Inc., a division of Mesirow & Co., Chicago. ■

Sponsors, managers predict mild recession, 10.5% inflation



By Michael Clowes

THE NATION's largest investment managers and the very largest of institutional investors—pension funds— are in remarkably close agreement about the likely severity of the long-expected recession, inflation in 1980 and the probable state of the stock market by the end of the year.

According to a survey of executives responsible for the administration of the nation's top 100 pension systems and chief investment officers of the top 100 investment management organizations, the 1980 recession, when it finally comes, will be less severe than the 1973-74 recession. These executives influence the investment of several hundred billion dollars.

The *Pensions & Investments'* Pulse Report survey, which will regularly seek the opinions of these executives on matters of interest to the investment community, found that 65.2% of the pension fund executives responding think the recession will be less severe than in 1973-74.

Only 19.6% of the fund executives thought the recession would be more severe and 15.2% predicted it would be of about the same severity.

Fewer chief investment officers, 5.6%, thought the recession would be more severe than in 1973-74, while 28% thought it would be about as severe as the earlier downturn.

However, the chief investment officers were much more in agreement on the longevity of the downturn than were the pension executives.

Sixty percent of the chief investment officers predicted the recession will last about nine months, 13% predicted six months, 11% predicted 12 months, 4% predicted 15 months, 7% predicted 18 months. Two of the respondents did not expect a recession, but merely a slowdown.

Among the fund executives, however, there was no one who did not expect a recession.

Further, only 35% of those responding predicted the recession would last about nine months.

The next most popular prediction on the tenure of the downturn among the fund executives was 12 months. This was the expectation of 24% of the respondents, while 17% predicted six months, 11% said 15 months, and 7% said 18 months.

Both groups agreed on the expected inflation rate for 1980. The average prediction by each was 10.5%.

In both groups the highest expected inflation rate for 1980 was 13%, while the lowest for the sponsors was 7.5% and for the money managers it was 8%.

Both groups expect the recession, when it comes, to bring the inflation rate down significantly, even from the 1980 average figure.

On average, the sponsor executives expect an inflation rate of 8.2% when the recession ends. The investment managers expect it to be about 8.4%.

The range of inflation rate expectations of both groups was identical, with the lowest predictions being 6% and the highest being 10%.

The investment managers were a bit more bullish about the direction of the stock market in 1980 than were the fund executives.

Some 66% of the investment managers expect the Dow Jones Industrial Average to be higher on June 30 than it was January 1, while 19% expect it to be lower and 15% believe it will be at about the same level.

Among the fund executives, however, only 46% expect the Dow to be higher on June 30 than on January 1, with 30% expecting it to remain in the same range as at the beginning of the year, and 24% expecting it to be lower.

Both groups expect interest rates to decline during the year, but, interestingly in view of the comments about the stock market, more fund sponsors than managers expect the rates to decline.

Among the sponsors, 67% expect interest rates to be lower at mid-year than they were at the beginning, while among managers only 62% expect this.

Among the sponsors, 22% expect interest

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Fund sponsors' favorite stocks for 1980

	# of mentions
IBM	5
Ralston Purina	4
AT&T	3
Smith Kline	3
Warner Lambert	3
Baker Intl.	3
United Tech.	3

Fund manager's favorite stocks for 1980

	# of mentions
General Motors	5
IBM	5
Amerada Hess	4
ARCO	4
Schlumberger	4
Citicorp	4
Philip Morris	3

Pulse . . .

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rates to remain at current levels during the year while 11% expect them to rise.

Of the money managers, 28% expect interest rates to remain near current levels, while 9% expect them to increase.

When asked to identify the five industry groups they expected to perform best during 1980 the fund executives listed 49 different industries and the chief investment officers named 53.

The favorites of fund executives were drugs (17), oil service (16), domestic oils (14), aerospace (10), office and business equipment (8) and electronics (8).

The favorites of the investment chiefs were aerospace and domestic oils, each mentioned by 16 of the respondents, drugs (15), banks (14), oil service companies (10) and electronics (10).

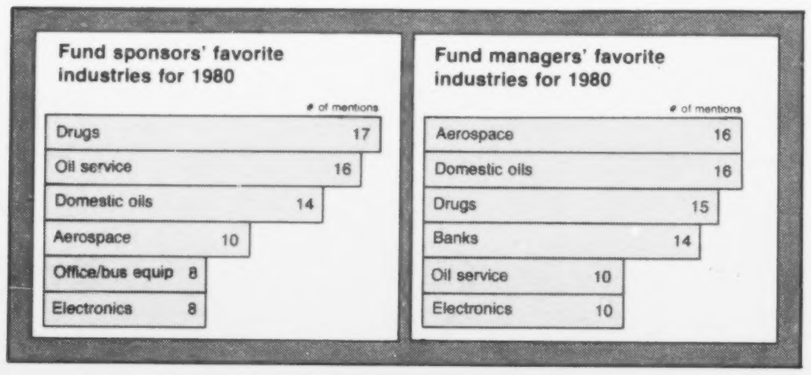
Both groups were asked to identify their five favorite stocks for 1980, and the sponsors named 107 different stocks while the investment executives mentioned 132.

The favorite stocks among the fund executives were IBM (5), Ralston Purina (4), AT&T (3), Smith Kline (3), Warner Lambert (3), Baker International (3) and United Technologies (3).

Perhaps the surprise on this list is Ralston Purina, a food company.

However, Alan Greditor, food analyst at Drexel Burnham Lambert in New York, said Ralston Purina has been frequently recommended in the past few months, and a widely-anticipated dividend increase finally was announced January 18.

The stocks most commonly selected by the chief investment officers were General Motors (5), IBM (5), Amerada Hess (4), Atlantic Richfield (4), Schlumberger (4), Citicorp (4), Philip Morris (3) and Northwest Airlines (3). ■



Will the 1980 recession be less severe, more severe, or about the same as 1973-74?

	Fund sponsors	Fund managers
Less severe:	65.2%	66.0%
More severe:	19.6	5.7
Same:	15.2	28.3
How long will it last?		
6 months	17.4%	13.2%
9 months	34.7	60.3
12 months	23.9	11.3
15 months	10.8	3.7
18 months	6.5	7.5
Other	6.5	3.7
Inflation (CPI) in 1980 will average:	10.5%	10.5%
Inflation rate at end of recession will be:	8.2%	8.4%
By June 1980 the Dow Jones Industrial Average will be:		
Higher:	45.6%	66.0%
Lower:	23.9	18.9
About the same:	30.5	15.1
By June 1980 long-term interest rates will be:		
Higher:	10.9%	9.4%
Lower:	67.4	62.2
About the same:	21.7	28.3

1980 Broker list shows 5% decline in analysts; increase in research

NEW YORK—A 1980 list of the top 25 brokerage houses shows a 5% decrease over last year in the number of analysts retained by the brokers.

Nelson Financial Communications prepared the list and based its ranking of brokerage houses on the number of companies followed by each broker.

The list, led by Merrill Lynch, also showed that the brokers increased the number of companies they follow very slightly, about 1%.

Oppenheimer & Co., had the biggest increase in the number of companies researched, from 409 to 525, according to the list. The firm also increased the number of analysts over last year from 31 to 38.

Drexel Burnham Lambert had the largest decline in the number of companies researched, down from 630 to 400, according to the report. Drexel, which declined from third place last year to 11th place this year, also decreased its number of analysts from 34 to 28.

The number of companies researched by the top 25 brokers ranges from Merrill Lynch's high of 1,117 down to a low of 216 followed by F. Eberstadt & Co. The average number of companies covered by the top 25 firms is 396.

Merrill Lynch led the number of analysts, 80. It was followed by Kidder Peabody & Co. with 44, Oppenheimer with 38 and Paine Webber Mitchell Hutchins with 32.

Among the top 25 firms, the number of analysts retained over last year by the brokers declined from 657 to 622, according to Walter Nelson, president of Nelson Financial Communication.

Allowing for duplications in companies, the number of companies researched by the top 25 firms over last year increased from 9,860 to 9,971.

Four brokers were added to the 1980 list compiled by Nelson Financial. They are: Alex Brown & Sons, ranked 18th; First Manhattan Co., ranked 20th; Neuberger & Berman, ranked 21st; and Fahnestock & Co., ranked 22nd.

Of the four brokerage firms that made the 1979 list but were not included this year, two of them were acquired by other brokerage houses. Blyth, Eastman Dillon was acquired by Paine Webber, and Loeb, Rhoades, Hornblower was acquired by Shearson.

Also not included on this year's list was Becker Securities Corp. and E.F. Hutton.

In the number of companies covered, Merrill Lynch far outstripped its closest competitor. Merrill Lynch researches 1,117 companies, while Salomon Brothers, ranked second on the list, follows 679 companies. ■

Rankings based on the number of companies covered as reported in the "Nelson 1980 Directory of Securities Research."

	Management Personnel	Number of Analysts	Companies Covered
1. Merrill Lynch	2	80	1,117
2. Salomon Brothers	6	26	679
3. Goldman Sachs	9	29	628
4. Oppenheimer & Co.	5	38	525
5. Paine Webber Mitchell Hutchins	1	32	522
6. Moseley Hallgarten & Estabrook	4	11	510
7. Dean Witter	3	31	483
8. First Boston	3	21	480
9. Smith Barney, Harris Upham & Co.	5	30	430
10. L. F. Rothschild, Unterberg, Towbin	2	29	415
11. Drexel Burnham Lambert	9	28	400
12. Kidder, Peabody & Co.	7	44	377
13. Shearson Loeb Rhoades	4	20	341
14. Bear, Stearns & Co.	2	20	339
15. Bache Halsey Stuart Shields	4	19	339
16. Donaldson, Lufkin & Jenrette	4	24	329
17. Lehman Brothers Kuhn Loeb	3	20	325
18. Alex Brown & Sons	1	13	321
19. Morgan Stanley	5	20	300
20. First Manhattan Co.	2	16	293
21. Neuberger & Berman	1	10	254
22. Fahnestock & Co.	1	12	245
23. Cyrus J. Lawrence	2	17	225
24. Wertheim & Co.	2	16	217
25. F. Eberstadt & Co.	2	16	216